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¶1. (U) Provided below is Embassy Buenos Aires' Economic and Financial Review covering the period December 1-19, 2008. The unclassified email version of this report includes tables and charts tracking Argentine economic developments. Contact Econoff Chris Landberg at landbergca@state.gov to be included on the email distribution list. This document is sensitive but unclassified. It should not be disseminated outside of USG channels or in any public forum without the written concurrence of the originator. It should not be posted on the internet.

Highlights

-- GoA unveils US$3.9 billion stimulus package, expands public works plan to US$31 billion
-- GoA reveals further details of auto sector stimulus program
-- Senate approves bill to expropriate Flag Carrier Aerolineas Argentinas
-- Argentine Congress approves Tax Moratorium and Capital Repatriation bill
-- U.S. Court ruling on private pension funds' US$200 million assets in U.S.
-- First private debt issuance since AFJP nationalization falters
-- Congress approves Emergency Economic Law and Financial Transaction Tax
-- November tax revenue disappoints
-- Economist Miguel Kiguel: Argentine Economy "not as bad as it looks"

NEW GOA STIMULUS PROGRAMS

GoA unveils US$3.9 billion stimulus package, expands public works plan to US$31 billion
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¶2. (SBU) President Cristina Fernandez de Kirchner announced December 4 an ARP 13.2 billion (approx. US$3.9 billion) stimulus package to foster growth and employment. This announcement followed her November 25 announcement of a tax incentive package and ARP 71 billion (approx. US$21 billion) public works program. Under the announced program, the GoA plans to finance consumption loans (ARP 3.5 billion), trade financing for the industrial sector (ARP 1.3 billion) and the agricultural sector (ARP 1.7 billion), loans for first-time car buyers (ARP 3.1 billion), and a support package for small-and medium-sized enterprises (ARP 3 billion). President Kirchner stated that the package will be financed with the cash previously held in time deposits by the

nationalized private pension funds (AFJPs), which were transferred on December 9 to the Social Security Administration (ANSES) December 9. The President also unexpectedly announced a five percentage point reduction in the tax rate on wheat and corn exports, bringing them to 23% and 20%, respectively. The GoA will grant a further export tax rate cut of 1 percentage point if wheat and corn production rise above average annual production of 13 million tons for wheat and 15 million tones for corn. (Note: local press has reported rumors that the GoA is considering a separate 5 percentage point tax cut on both soy and sunflower exports, currently at 35% and 32%, respectively.)

¶3. (SBU) On December 15, the GoA announced the expansion of its previously announced public works program from ARP 71 billion to ARP 110 (roughly US$31 billion). The main objective of the program is to preserve jobs and will be centered on infrastructure, energy, and housing projects. The GoA will implement this program over multiple years, beginning in 2009 US$16 billion outlay (about 4.4% of estimated 2009 GDP and almost double the amount expected to be spent on public works projects in 2008). The GoA has also stated that about US$21 billion of the program is already financed, although it has not given details as to the source of this funding.

¶4. (SBU) Bankers and business leaders have reacted cautiously, calling the various stimulus packages a step in the right direction, but lacking details on implementation. Banco Macro President Jorge Brito, known to have a close relationship with the government, stated: "The president aims to revive the economy in two ways, through credit to consumers and to producers. The total sum is significant.

We'll want to read the fine print, but I see this as very positive on first glance." However, many local and international analysts have voiced skepticism about the impact of the measures, since there is no new funding for this program. The AFJP deposits were already part of the banking sector's funding base, so redirecting these monies to pay for the GoA's announced programs will result in an equal reduction in bank credit to the private sector.

GoA reveals further details of auto sector stimulus program
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¶5. (SBU) On December 6, recently appointed Production Minister Debora Giorgi, along with ANSES Director Amado Bodou and Secretary of Industry Fernando Fraguio, provided further details on the ARP 3.1 billion (US$890 million) loan program to promote the purchase of new cars by first-time car buyers. Minister Giorgi stated that the six main domestic automakers will each offer two models selling for ARP 30,000-40,000 apiece, and stated that the purpose of the program is to "reorient funds from financial speculation to bolster the economy and maintain jobs in a vital industry for the local economy." Carmakers participating in the scheme must promise to retain workers and restrain profit margins on the cars sold under this program. Buyers can choose a pre-savings plan under which delivery times are determined by lottery, or they can take advantage of low-interest financing. Payments will range at around ARP 800 (US$230) a month with a maturity of up to 60 months (this monthly installment assumes an interest rate of 11-12%). The Minister estimated that the scheme could boost demand by 100,000 units a year. (January-November car production totaled 570,000 units.)

¶6. (SBU) The president of the car dealers association, Ernesto Baldassare, questioned the idea of promoting automobile purchases in the middle of a crisis, arguing that the GoA could have a bigger impact on workers incomes by reducing the income tax. The car dealer association's vice-president, Abel Bonrad, further cautioned that the GoA plan to stimulate car sales would not be a panacea for the auto companies or car dealers.

Senate approves bill to expropriate Flag Carrier Aerolineas Argentinas
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¶7. (SBU) On December 17, the Argentine Senate voted 42 to 21 in favor of a bill to expropriate the troubled national airline, Aerolineas Argentinas, and its smaller carrier Austral, marking the end of almost two decades of Spanish control. (See Nov. 28 Financial and Economic Review for background.) The Senate's action took place after months of unsuccessful negotiations between the carrier's Spanish owners (Madrid-based Marsans Group) and the GoA. The bill declares the service provided by the carriers to be a vital public service, given the vast size of the country and the carrier's duty to serve even unprofitable routes. Ousted owners Marsans, a Spanish travel company, confirmed that it would pursue international arbitration via the International Center for the Settlement of Investment Disputes (ICSID -- allowed for under the Spain-Argentina Bilateral Investment Treaty), since it considers the takeover "arbitrary and illegitimate." Aerolineas and Austral control about 80% of the domestic air market, but reportedly operate all of their 33 routes at a loss. President Cristina Fernandez de Kirchner is expected to sign the bill into law before the end of the year.

Argentine Congress approves Tax Moratorium and Capital Repatriation bill
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¶8. (SBU) Following a ten-hour debate, and facing stiff resistance from opposition party members, the Argentine Chamber of Deputies approved on December 10 the GoA's bill to provide tax incentives to foster job creation and encourage the repatriation of funds held abroad (estimated at over US$130 billion). The Argentine Senate followed suit December 18, with the GoA easily garnering sufficient votes for the bill, although again in the face of strong criticism from opposition parties. (Note: President Cristina Fernandez de Kirchner submitted the law to Congress November 25. For details, see November 28 Economic and Financial Report). The bill spawned a major debate in the Congress and in the press over whether it may facilitate money laundering, and the Financial Action Task Force sent a letter to the GoA asking for details on the draft law and emphasizing the need to include provisions to "verify the origin of the money or other assets that may be introduced into the financial system as a result of this act." (The FATF letter leaked to local

press December 16). During the Senate debate, the opposition predicted that the bill will turn Argentina into "a paradise for money laundering."

¶9. (SBU) Aside from concerns over money laundering, there is also disagreement over whether the bill will have any real impact. For example, well-known local economist Miguel Bein estimates that the new measures could resultp`:OQzpital, with the other half from other corporate tax breaks included in the bill, related to adding new workers and formalizing informal sector employees.) However, many other analysts discount the impact. For example, Credit Suisse analysts argue that the tax amnesty will not result in a significant amount of funds being repatriated as long as the GoA maintains its current policies, pointing out that the market's complete lack of confidence in the Argentine economy, institutions, and financial system has resulted in large-scale capital outflows. (Capital flight during the first three quarters of 2008 totaled over US$16 billion, followed by a spike in outflows of US$4.5 billion in October.)

Finance

U.S. Court ruling on private pension funds' US$200 million assets in U.S.
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¶10. (SBU) U.S. District Court Judge Thomas Griesa of the Southern District of New York issued December 11 an opinion noting that about US$200 million in deposits in the United States of the private pension funds recently nationalized by the GoA and currently managed by ANSES, are subject to attachment to satisfy the claims of holdout creditors. Specifically, Judge Griesa concluded that he had jurisdiction over ANSES, that ANSES's assets are subject to attachment and execution to the same degree as the assets of the Republic of Argentina, and that the assets of the ten Argentine private pension funds were used for a commercial activity within the waiver of sovereign immunity found in the Foreign Sovereign Immunities Act (FSIA). In response, the GoA promised to dispute this decision in the U.S. Court of Appeals. (This legal opinion followed a previous ruling October 31, in which the Judge issued a temporary restraining order freezing the transfer of the assets of ten Argentine private pension funds to ANSES in response to lawsuits filed by holders of untendered, defaulted Argentine government bonds.)

First private debt issuance since AFJP nationalization falters
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¶11. (SBU) The market has closely monitored the effort by an Argentine cement company, Minetti, to become the first to try to issue debt since the GoA nationalization of the AFJPs sent local equity and fixed income markets into a tailspin. Minetti, which is 72% controlled by Spanish company Holcim, was scheduled to close its ARP 100 million issuance of ONs (tradable debt instruments) on December 5. However, it was forced to extend the debt subscription period untilDecember 12 when ANSES unexpectedly decided to withdraw its purchase orders for the issue just minutes before closing. According to local press reports, ANSES authorities had previously confirmed to the company that it would back and participate in this transaction. Minetti planned to issue ARP 100 million in ONs with a 36-month maturity and a variable rate pegged to BADLAR (the average interest rate paid on time deposits of more than ARP 1 million). On December 12, Minetti announced it would extend the debt subscription period a second time, to December 19. Local press quoted stock brokers stating that Minetti's failure to close the issuance sent a "bad signal" to the private sector, which has few other sources of large-scale debt financing besides ANSES.

FISCAL

Congress approves Emergency Economic Law and Financial Transaction Tax
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¶12. (SBU) On December 10, the Senate approved the extension of the Economic Emergency Law and Financial Transaction Tax (FTT) until December 2009. Given that the Chamber of

Deputies had already approved both bills (see Nov. 28 Economic and Financial Review), they will enter into force after publication in the Official Gazette. The Economic Emergency law delegates legislative powers to the executive branch and allows the President to enact a wide range of economic policies by decree (e.g., debt and utility tariff renegotiation, extend social assistance plans, implement measures to foster employment and growth). The FTT's 2009 annual collection is budgeted at ARP 22 billion (about US$6.4 billion), of which 70% goes to the federal Treasury and 30% to the provinces.

November Tax Revenue Disappoints

¶13. (SBU) The GoA announced December 3 that November tax revenues increased 18% y-o-y to ARP 21.7 billion, below market expectations of ARP 24.5 billion and less than half the 37.5% growth rate seen in October. For comparison, from January trough October, tax collection increased 38.5% y-o-y.

Tax collection fell in real terms, when using actual or "true" estimates for inflation, which according to most private analysts is approximately 20% (compared to the official INDEC estimate of 8%). The worse-than-expected November tax receipts is the result of the sharp economic slowdown, which affects income taxes and VAT, as well as lower international commodity prices, which reduced GoA export tax collection. During November, labor contributions rose 55% y-o-y, VAT revenues increased 16% y-o-y, and income tax revenues increased 13% y-o-y. Export trade tax revenues actually decreased 0.5% y-o-y. VAT collected on imports also fell on lower growth in consumer spending and investment, and import restrictions implemented by the GoA. In the first eleven months of the year, tax revenues reached ARP 246 billion, ARP 28 billion below the Argentine Central Bank's consensus forecast of ARP 274 billion.

¶14. (SBU) Analysts expect tax revenue growth to continue to decline, as the slowdown in economic activity deepens and commodity prices remain depressed. Analysts also raise the possibility that tax revenues will further decline due to reduced compliance, as taxpayers turn to the common local practice of withholding tax payments during rough times. According to JPMorgan, November's lower tax collection stands in sharp contrast with seasonal patterns (November is usually a high revenue month) and flashes a warning for fiscal performance. JPM further estimates that the subset of activity-linked taxes (VAT, FTT, export taxes) have contracted in real terms, suggesting that economic growth is likely to decelerate further. (JPM predicts a 1% GDP contraction in 2009, but with increasing downside risks.)

¶15. (SBU) Local media has reported rumors that the head of AFIP (IRS-equivalent) Claudio Moroni will soon be replaced. Moroni was appointed Head of AFIP in May to complete the term of prior AFIP-head Alberto Abad. Moroni's appointment expires December 10, and the press quotes unnamed "senior GoA officials" stating that the GoA will give Moroni a temporary renewal, through about March-May 2009, so that he will take the blame for decreasing tax collection and for any fallout from defending the GoA's tax moratorium and capital repatriation bill (currently pending in the Senate). Ricardo Echegaray, currently Head of the ONCCA (Oficina Nacional de Control Comercial Agropecuario, National Agriculture Trade Office), is considered a possible replacement. The name of Sergio Montoya, the head of Buenos Aries province tax collection entity ARBA, has also been floated as a potential replacement.

Macro Outlook

Economist Miguel Kiguel: Argentine Economy "not as bad as it looks"
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¶16. (SBU) This item summarizes Economist Miguel Kiguel's December 10 conference call for his domestic and foreign clients. Kiguel is the Director of Econviews, an Argentine-based economic think tank. He is a well-respected economist who was Undersecretary of Finance at the end of the 1990s.

-- Overview: While arguing that negative perceptions of Argentina's economy and outlook are worse abroad than in Argentina, Kiguel acknowledged that pessimism is widespread, as reflected in Argentine debt spreads at default levels. For example, Kiguel noted that the 5-year CDS (credit default

swap) reached 4,091 basis points on December 12, compared to 462 bps at the end of 2007. This reflects the market's nervousness about Argentina's capacity and willingness to pay its debts (especially the latter). Kiguel said it is critical to monitor: 1) the peso exchange rate, the evolution of deposits, and BCRA international reserves levels; 2) the

economic slowdown; 3) the GoA financial program; 4) commodity prices and the external accounts.

-- The exchange rate and deposit levels: Kiguel noted that a sharp, rapid depreciation of the peso to levels of 3.80 ARP/USD or higher, as the industrial sector has called for (in order to keep pace with the depreciation of the Brazilian Real), could generate a run on deposits. Thus, the Central Bank (BCRA) prefers to pursue a gradual and managed depreciation, while using tighter capital controls and "moral suasion" tactics with financial institutions to limit dollar purchases (and minimize peso-denominated deposit outflows). Kiguel explained that the banking sector has already experienced two mini-runs on the peso: first at the height of the farm crisis in April-May, and recently in October, when the GoA announced its decision to nationalize the AFJPs in the midst of the global credit crunch's intensification. (Note: private peso denominated deposits plunged 5.2% in October, compared to the 4.4% drop in May, the worst month of the farm crisis.) Largely due to the BCRA and GoA regulatory agencies' unorthodox methods of limiting dollar trading, deposits have recovered and stabilized. He predicted that real interest rates will have to remain positive throughout 2009 to maintain deposit levels. Kiguel estimates that the peso will end 2008 in the range of 3.45-3.50 ARP/USD, but will further depreciate to about 4.10-4.20 by the end of ¶2009. He expects the BCRA to continue with its crawling peg policy and avoid large jumps in the currency. (Post Comment: According to press and other sources, one negative consequence of the gradual depreciation is that is creates incentives for exporters to delay repatriation of foreign currencies and for debtors to delay payments to creditors.)

-- BCRA reserves: Kiguel stated that the BCRA reports reserves at about US$46 billion, but net of BCRA borrowing from the Bank for International Settlements are more in the range of US$40-41 billion. Kiguel still considers this a solid level, giving the BCRA sufficient means to defend the peso.

-- Economic slowdown: the economy is showing obvious signs of rapid deceleration (e.g., falling construction, cement, and car production, plummeting car sales) and he considers recession likely in 2009. He estimates a 1% GDP contraction for 2009, and notes that this will have significant adverse consequences for the fiscal accounts and GoA financial program.

-- GoA financial program: Although the GoA's financing needs increase almost 50% in 2009, Kiguel believes the GoA has sufficient sources of funding to make payment. Giving as an example a 3% of GDP primary surplus for 2009 (which he noted may be optimistic due to the slowdown and falling tax collection), Kiguel believes the GoA will relatively easily fulfill its financing needs of about US$9 billion. (Note: Kiguel's estimates for primary surplus include the GoA accessing the roughly US$4 billion in annual pension flows to ANSES resulting from the AFJP nationalization.) The amount is reduced by US$3.5 billion after taking into account the GoA's enhanced ability to rollover debt with ANSES, now that it has taken on AFJP assets of about US$25 billion. (Note: Kiguel predicted that the GoA can rollover US$2 billion of mandatory debt buybacks and US$1.5 billion of amortizing bonds previously held by AFJPs. Other Economists have higher estimates for both the buybacks and bonds coming due.). Kiguel considers the resulting US$5.5 billion manageable, particularly since he expects the GoA to attempt a debt swap for the "P^Ls, financial needs would
reach US$7 billion, or only US$3.5 billion after taking advantage of the newly acquired AFJP assets to rollover debt with ANSES. Under the more pessimistic scenario of a 2.5% of GDP primary surplus, financial needs would increase to US$11 billion (or US$7.5 billion after rollovers with ANSES), which Kiguel still considers easily manageable. Kiguel optimistically expects the GoA to show prudence in managing expenditures during 2009 (based on his assessment of past GoA

fiscal prudence). He estimates that the GoA will increase expenditures by only about 16% in nominal terms, by limiting nominal increases in salaries and pensions to only about 10-12%.

-- Commodity prices: While they have fallen sharply since the second quarter of 2008, Kiguel noted that they still remain at relatively high levels compared to the average of the last fifteen years.

-- External accounts: Kiguel predicted a US$6 billion trade surplus in 2009, compared to his estimate for 2008 of US$12 billion. His 2009 estimate is based on expectations of a US$10 billion decline in exports and US$5-6 billion decline in imports. The current account will be close to zero in 2009, which along GoA payments abroad and capital flight should result in a US$8 billion decline in international reserves (with BCRA reserves ending 2009 at about US$32 billion.)

-- Concerns and Downside Risks:

(a) Under the outlook as depicted above, Kiguel believes Argentina's economic situation is manageable. However, he acknowledged that the GoA has made many mistakes in the past, and noted that many observers believe the Kirchner administration is prepared "to do anything to maintain power." This uncertainty about GoA policies and actions undermines confidence in the financial sector, and could lead to accelerating capital flight.

(b) Kiguel noted that 2009 is an election year, and in normal times the Kirchners would look to increase spending leading up to the October elections (as the GoA did prior to the October 2007 presidential elections). However, Kiguel argued that the GoA has little ability to pursue counter-cyclical, stimulative policies, given that it does not have access to sufficient financing to increase spending and lower interest rates stemming from stimulative monetary policies would likely trigger capital outflow and higher inflation. (Note: Kiguel said that the inflation rate is decelerating, but will still end 2008 around 20% and will not fall below the mid-teens in 2009.)

(c) Argentina is facing a difficult international environment, with high financial volatilityand falling commodity prices. Nevertheless, Kiguel argued that the current situation is different from that of 2001-2002, when a crisis in Argentina was all but unavoidable. In particular, Kiguel highlighted the following differences to the 2001 situation: 1) BCRA reserves are currently high and can be used, unlike in 2001 when they had to back the monetary base; 2) the BCRA has a role as lender of last resort, since the banking system works in pesos; 3) GoA financial needs are much lower; 4) the exchange rate can serve as escape valve and is not overvalued; 5) export prices are still at reasonable levels.

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